The Northampton Retirement Board

N E W S L E T T E R

July 2013 *News for our retirees and members in service*

Health insurance reform bill targets future retirees

In an effort to rein in increasingly burdensome health care costs, Governor Deval Patrick filed legislation in January aimed at reducing or eliminating post-employment health insurance benefits for thousands of public workers. Originally expected to be enacted on July 1st of this year, it has since taken a back seat to Patrick's revenue-generating transportation and education legislation.

The Retired State, County and Municipal Employees Association of Massachusetts (RSCME) reports that state legislators have been inundated with calls and letters from concerned public employees expressing their disapproval at the prospect of losing health insurance benefits upon retirement. Some workers would be exempt from the reform, but if passed as written, many of our members will see their annual health insurance costs increase by thousands of dollars when they retire. Many others will see a retirement benefit they once took for granted disappear entirely.

Hearings on H59 are expected to begin in September after the summer recess. Visit massretirees.com to follow news on this very important bill. Additional information on H59 can be found on our website and updates will be posted as they become known.

RETIREMENT SECURITY: Defined benefit or defined contribution?

A study mandated by Chapter 176 of the Acts of 2011 was commissioned to evaluate further structural changes to our public pension system. One of the ideas being studied is the introduction of an optional 401(k)-type *defined contribution* (DC) plan for public employees. This article will discuss basic differences between these two plan types.

Defined Benefit: Under our *defined benefit* (DB) plan, employees contribute a portion of their wages to fund future benefits and after reaching certain minimum age and service requirements earn a defined pension benefit that is based on total years of service, average salary, and age at retirement. The funding of the future benefit is derived from member contributions plus a return on investments. The net normal employer cost of the plan is about 3.5% of payroll. To see how economical this is, consider that private employers must pay over 6% of payroll into Social Security.

The state's public retirement systems originally operated as pay-as-you-go plans. This changed in the mid-1980s when municipalities were mandated to fund the pension liabilities on their books. Funding schedules were put in place to pay down the huge unfunded liability that had accrued. Throughout the 1990s the funded status of systems rose steadily. Northampton went from about 30% funded in the 1980s to over 75% by 2000. Nearly all systems were on target and exceeding goals, but two periods of market

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The Northampton Retirement Board

MEMBERS OF THE BOARD

- **Joyce Karpinski**
  Chairperson
  EX-OFFICIO
- **Shirley LaRose**
  ELECTED
- **Michael Lyons**
  ELECTED
- **Thomas Sullivan**
  APPOINTED (BOARD)
- **Susan Wright**
  APPOINTED (MAYOR)

RETIREMENT BOARD STAFF

David Shipka
Administrator

Elsie Irizarry
Administrative Clerk

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RETIREMENT SECURITY (*continued)*

decline conspired to regrow the unfunded liability. First the decline from 2000-2002, then followed five years later by the even larger decline that culminated in 2008.

Because of challenges in paying down unfunded liability, questions of sustainability have arisen. Recent reforms, such as the revised age factor tables for new hires, should help to ensure our system *is* sustainable. In fact according to state actuary Jim Lamenzo, since career employees contributing 9% already completely fund their future benefit[1], new members may end up overfunding.

Defined Contribution: A distinguishing feature of DC plans is that investment risk is borne by the employee rather than employer. Under this type of plan retirement savings are subject to stock market volatility. On the other hand, participants assume market *rewards* as well as risks.

While a well-managed DC plan can assuredly produce satisfactory retirement savings, achieving a financially secure retirement under a DC plan proves to be a challenge for many individuals. Because employees make decisions on how to invest contributions, poor choices can hinder the ability of participants to save adequately for their retirement. Unavoidable market downturns can erase years of gains. Further hindering savings efforts can be the participants themselves. In 2010 about a quarter of contributions to DC plans disappeared due to "leakage" attributed to hardship withdrawals, loans and cash-outs[2].

Compared with DB plans, DC plans generally offer increased portability. This can be desirable to the private sector worker with easily transferable skills. Of course many municipal occupations require skills which are not readily transferable to the private sector; police officers, firefighters and public maintenance workers come to mind.

Short-term employees might be better served with a DC plan since DB plans are designed to reward long-tenured employees. This is especially true for workers who may be too old to put in the required vesting period.

As for cost, proponents claim DC plans can save money but it is hard to see where the savings would be since fees associated with DC plans are typically higher than with DB plans[3]. The unfunded pension liability towns are grappling with would not just disappear even if all new hires were to be put into a DC plan; it would still have to be paid down.

Developments on this issue will be posted on our website.
David Shipka

1. Lamenzo, J. (2013). PERAC Pension News #33: Employee's Share of Benefit. *Public Employee Retirement Administration Commission*
2. Kadlec, D. (2013). Cash Leaking Out of 401(k) Plans at Alarming Rate. *Time Magazine* .
3. *Top Ten Advantages of Maintaining Defined Benefit Pension Plans.* NCPERS.org.

Shirley LaRose wins reelection to the Board

Shirley LaRose ran unopposed for reelection to the Retirement Board and began her 7th term on July 1st after 18 years of serving on the Board. Congratulations!

Need an estimate of benefits?

Stop by the Retirement Office or give us a call if you need assistance as you plan for your retirement. You may also utilize our online benefits estimator to quickly obtain information. As always, inquiries about your benefits are kept confidential.

Online:
northamptonma.gov/retirement/estimate

Retiree cost-of-living adjustment for FY14

The NRB approved a 3% cost-of-living adjustment for members that retired prior to July 1, 2012, effective July 1st. The increase is on Northampton's $13,000 COLA base (a maximum increase of $390 to the annual allowance of retirees).

About the Northampton Retirement Board

The Northampton Retirement Board became operative on July 1, 1937 and is one of 106 retirement systems operating independently to provide defined benefits for public employees under Massachusetts General Laws Chapter 32. The Board is chaired by Joyce Karpinski.

Governance:

- **Joyce Karpinski** – City Auditor (ex-officio)
- **Shirley LaRose** – Retired City Treasurer (elected member)
- **Michael Lyons** – Retired City Auditor (elected member)
- **Thomas Sullivan** – Investment Consultant (Board appointed 5th member)
- **Susan Wright** – City Finance Director (Mayor's appointee)

Staff:

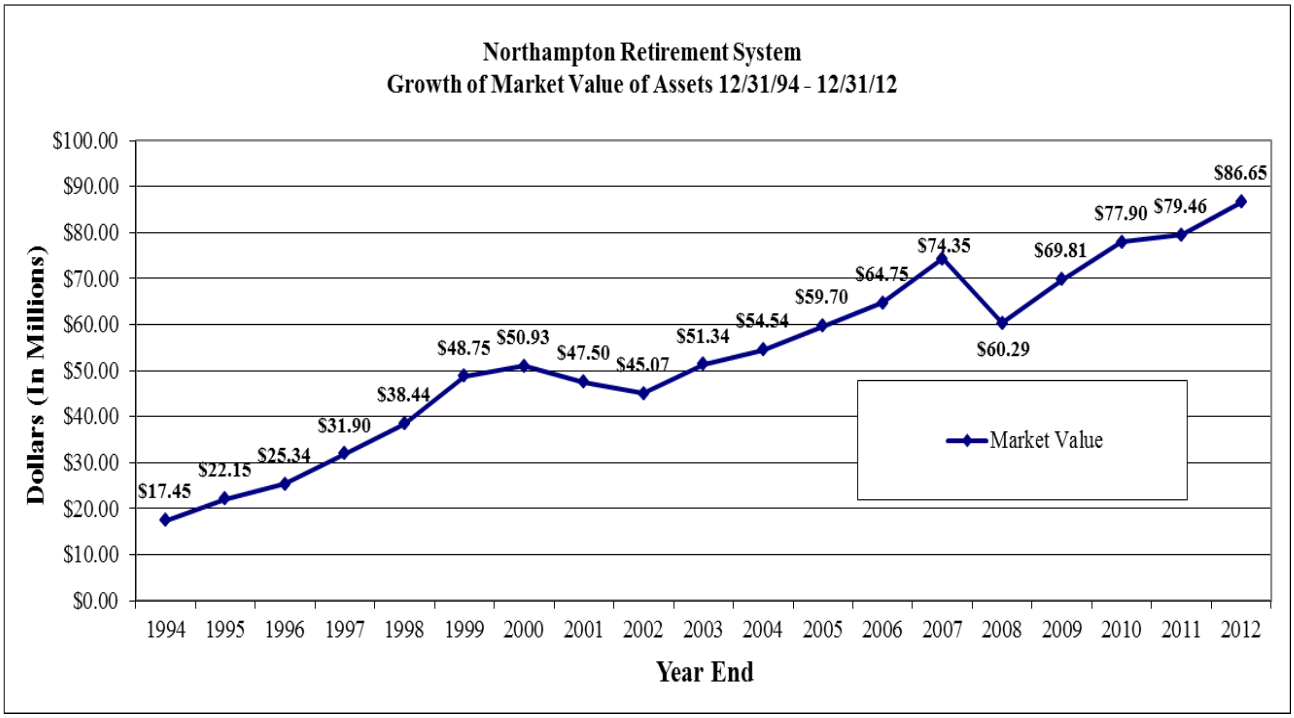
- **David Shipka** – Administrator
- **Elsie Irizarry** – Administrative Clerk

Investment Report for 2012

Prepared for our members by our investment advisor, the de Burlo Group, Inc.

The stock market exhibited strength during 2012, with the Standard & Poor's 500 Stock Index returning 16%. By comparison, the stocks in the Northampton Retirement System performed well, up nearly 14%. The entire portfolio (including stocks and bonds) of the Northampton Retirement System also had good results, returning approximately 10.5% for the year.

As the graph below shows, the System's assets reached a new peak of $86.65 million at the end of December, 2012, an increase of $7.19 million over the year earlier level. Growth in value over the last three years has come from investment returns rather than net new appropriations.



Over the past five years Northampton's assets compounded at an average rate of 4.0% per year. For the past 10 years, Northampton has earned 7.8% per year. Although the sharp decline in 2008 limited average annual returns for more recent periods, the System's returns over the long term demonstrate the System's sustainability. During the 28 years that PERAC has been tracking performance of municipal pension funds, the Northampton Retirement System has earned an annualized return of 9.4%.

Northampton's annual appropriation to the Retirement System and the funding schedule projected for the System are based upon an assumed rate of return of 7.75%. The 9.4% annualized return the System has earned over the 28 years is well in excess of that. This is on par with PRIT's 9.6% per year.

The Financial Markets in 2012

The stock market got off to a strong start but declined precipitously in April and May, giving up most of the earlier gains. In June the market initiated an explosive rally, extending through the end of September. The market returns during this period accounted for the majority of the gains during the year since the last quarter was down slightly.

For the year in total, riskier, more cyclical assets performed much better than those safer, more defensive assets. The Dow Industrial Average, for example, was up only 7.2%. On the other hand, the Russell 2000, an index of smaller capitalization stocks, increased 14.6% and the Nasdaq, the index heavy in technology stocks, was up 15.9%. International indices, particularly emerging markets, also performed quite well.

The market strength was due in large part to central bank easing not only in the U.S. but also in other countries throughout the globe. This primed the market for a steep upturn between June and September. Additional good news in the U.S. housing market, retail sales, and small business sentiment also provided fodder for the stock market rally.

The Economy

2012 highlighted significant central bank easing. With the threat of stalling economies in the euro-zone, Brazil, China, and the U.S., central banks throughout the globe injected massive and unprecedented amounts of liquidity in order to stimulate their economies, correct employment weakness, and shore up banking systems.

The U.S. economy labored along during 2012, realizing positive growth yet limited results when compared to previous economic recoveries. A number of developments boosted the economy forward during the year and could even serve as catalysts for quicker growth in the near future. For example, home prices firmed up through the year and the recovery expanded in all geographies. Housing starts and building permits also rose. As housing continued to mend, the sector contributed more to the economy through job creation and consumer confidence associated with higher housing prices.

On the negative side, the employment picture did not improve substantially during the year. Although the unemployment rate declined slightly, it is thought to be understated by the number of people abandoning their efforts to find work. Employment payrolls, although positive, did not pick up momentum through the second half of 2012 and the number of hours worked did not inspire confidence.

The Northampton Retirement System Portfolio

The assets of the Northampton System remain well diversified as the table below shows. During the year our investment adviser increased stocks from 56% of the total portfolio to 61% with an emphasis on increasing domestic stocks. Conversely, they lowered the commitment to bonds from about 39% of the portfolio to 36%, locking in gains from rising bond prices, helped by Federal Reserve policy. With the Retirement System Board’s approval, the manager also reduced the investment in PRIT’s hedge funds because of concerns about management and performance.

	Allocation at 12/31/12	**$ Millions**	**% of Total**
Cash	**Cash**	**1.53**	**1.8**
	Domestic Stock	45.40	52.4
	International Stock	5.37	6.2
	Real Estate	1.96	2.2
Equity	**Total Equity**	**52.73**	**60.8**
	Domestic Bonds	26.83	30.9
	International Bonds	3.26	3.8
	Below Invest. Grade	0.95	1.1
Fixed Income	**Total Fixed**	**31.04**	**35.8**
	Hedge Funds	0.74	0.9
	Private Equity & Venture Capital	0.61	0.7
PRIT Investments	**Total PRIT Investments**	**1.35**	**1.6**
Total		**86.65**	**100.0**

Totals may not add due to rounding.

Outlook for 2013

Like the first quarters of each of the past three years, stocks were off to a very strong start this year. Investors poured money into the equity markets due to a number of positive factors such as improving corporate profits, low rates, and moderate yet uneven economic growth. The second quarter followed suit as investors continued to buy stocks. Additionally, housing continues to show strength and employment has stabilized.